

City of Detroit

CITY COUNCIL

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ANNE MARIE LANGAN
DEPUTY DIRECTOR
(313) 224-1078

TO: COUNCILMEMBERS

FROM: Irvin Corley, Jr., Director *ICJ.*
Anne Marie Langan, Deputy Director *ML*

DATE: June 13, 2008

RE: Proposed Ordinance to Amend the 1973 Defined Benefit/Defined Contribution (Annuity) Plan of the General Retirement System to Establish an Employee Loan Program for the 1973 Defined Contribution Plan **(Not Recommended)**

This proposed ordinance was moved from the Internal Operations Committee on June 12, 2008 to be presented to the Committee of the Whole at the next Formal Session. We recommend that before this ordinance amendment is considered by the Committee of the Whole that the Labor Relations Director provides an explanation as to why this ordinance would interfere with the collective bargaining process.

Our office has repeatedly asked since our report on this proposed ordinance was delivered to Council on February 8, 2008, that the Administration weigh in on this issue via the Labor Relations Director as well as the Law Department's Labor Section.

While no communication has yet come via the Council table from the Administration on this matter, we were able to conduct a productive meeting this past Tuesday, June 10, with the Labor Relations Director, Barbara Wise-Johnson. Ms. Johnson explained her many concerns to us in Fiscal and RAD and committed directly contacting the Councilmembers of the Internal Operations Committee by Monday June 16.

Secondly, the Fiscal Analysis Division had attempted on its own to recommend modifications to the ordinance language in order to ensure that the City/General Fund would not bear any of the costs of this program. If an employee wishes to participate, they would pay all service and administration costs. We enlisted RAD to assist us in crafting a few sentence modifications that are attached here.

We believe that these few changes both strengthen the intent of Council's policy and clarify the manner in which the costs will be covered by the loan applicants.

Attached are the recommended changes, which are in bold italics, the report we provided in February and the ordinance as it was written at that time.

The Fiscal Analysis Division cannot recommend this ordinance due to the concerns that Labor Relations has.

However if Council chooses to go forward we recommend that Council require the recommended these proposed ordinance language changes be implemented prior to authorizing the ordinance to ensure there will be no costs to the City and the General Fund.

We are available to respond to any questions.

Attachments

cc: Council Divisions
Auditor General
Norman White, Finance Director
Pamela Scales, Budget Director
Barbara Wise-Johnson, Labor Relations Director
John Johnson, Corporation Counsel
Walter Stampor, Executive Secretary, Retirement Systems
Dennis Mazurek, Law Department
Kathleen Leavey, Law Department
Kerwin Wimberley, Mayor's Office

SUMMARY

This proposed ordinance amends Chapter 47 of the 1984 Detroit City Code, *Retirement Systems*, Article II, *1973 Defined Benefit/Defined Contribution (Annuity) Plan of the General Retirement System*, by adding Section 47-2-22, *Participant Loan Program*, to provide a loan program whereby a participant of the 1973 Defined Contribution Plan may borrow funds from his or her **Annuity Savings** account subject to requirements and limitations of: 1) the United States Internal Revenue Code, 26 U.S.C. 1 *et seq.*, and 2) the Rules of the Board of Trustees of the General Retirement System, which may be established from time to time.

BY COUNCIL MEMBER _____:

AN ORDINANCE to amend Chapter 47 of the 1984 Detroit City Code, *Retirement Systems*, Article II, *1973 Defined Benefit / Defined Contribution (Annuity) Plan of the General Retirement System*, by adding Section 47-2-22, *Participant Loan Program*, to provide a loan program whereby a participant of the 1973 Defined Contribution Plan may borrow funds from his or her **Annuity Savings** account subject to requirements and limitations of: 1) the United States Internal Revenue Code, 26 U.S.C. 1 *et seq.*, and 2) the Rules of the Board of Trustees of the General Retirement System, which may be established from time to time.

IT IS HEREBY ORDAINED BY THE PEOPLE OF THE CITY OF DETROIT THAT:

Section 1. Chapter 47 of the 1984 Detroit City Code, *Retirement Systems*, Article II, *1973 Defined Benefit / Defined Contribution (Annuity) Plan of the General Retirement System*, be amended by adding Section 47-2-22, *Participant Loan Program*, to read as follows:

CHAPTER 47. RETIREMENT SYSTEMS
ARTICLE II. 1973 DEFINED BENEFIT / DEFINED CONTRIBUTION (ANNUITY)
PLAN OF THE GENERAL RETIREMENT SYSTEM

Sec. 47-2-22. Participant Loan Program.

(a) Established. Any loans granted or renewed shall be made pursuant to a Participant Loan Program which shall conform with the requirements of Section 72(p) of the Internal Revenue Code, 26 U.S.C. 1 *et seq.* Such loan program shall be established in writing by the Board of Trustees, and must include, but need not be limited to the following:

- (1) The identity of the administrator of the Participant Loan Program;
- (2) A procedure to apply for loans, the amount of loan that will be approved or denied, and limitations, if any, on the types and amount of loans offered; **and**

~~(3) The procedures under the program for determining a reasonable rate of interest and~~

~~(4)(3) The events constituting default and the steps that will be taken to preserve plan assets.~~

(b) The Loan Program.

(1) This Loan Program shall be contained in a separate written document copies of which shall be made available in the offices of the City of Detroit General Retirement System for prospective participants in the program. The Board of Trustees is authorized to adopt rules and regulations, from time to time, to govern the administration and the operation of this program. Copies of the rules shall also be made available to prospective participating members of the system in the offices of the General Retirement System; and

(2) All collective bargaining agreements which accept the terms of this section are specifically agreeing to be subject to the Board's authority to modify or amend the Participant Loan Program from time to time, including during the effective term of the applicable labor agreement and no such modification or amendment shall be deemed a violation of said labor agreement and no grievance or other form of action shall be effective to overturn or alter the Board's decision.

(c) Eligibility. Subject to rules and procedures established by the Board ~~as allowed by IRS rules and this Ordinance~~, loans will initially be made only to non-union participants of the General Retirement System. Union employees will be eligible ~~when if~~ their respective bargaining unit ~~has accepted the program and include it as part of their collective bargaining agreement~~. Former participants, spouses of participants, and beneficiaries are not eligible to receive any loans from the Plan. Subject to rules and procedures established by the Board, a participant who has been in the plan for twelve (12) months or more is eligible to apply for a loan from this plan.

(d) Amount of Loan. A participant who has satisfied applicable rules and procedures may borrow from his or her Annuity Savings account an amount, which does not exceed fifty percent (50%) of the participant's vested accumulated balance, or ten thousand dollars (\$10,000.00) reduced by the excess, if any, of: 1) the highest outstanding balance of loans from the trust during the one (1) year period ending on the day before the date on which the loan is made, or 2) the outstanding balance of loans from the trust on the date on which the loan is made, whichever is less. The minimum loan amount shall be one thousand dollars (\$1,000.00). A participant may obtain a maximum of one loan per year. No more than two loans can be outstanding at any given period.

(e) Terms and Conditions. In addition to such rules and procedures that are established by the Board, all loans shall comply with the following terms and conditions:

(1) Loan applications shall be in writing;

(2) Loans shall be repaid by equal payroll deductions over a period not to exceed five (5) years, or, where the loan is for the purpose of buying a principal residence, a period not to exceed fifteen (15) years. In no case shall the amount of the payroll deduction be less than twenty dollars (\$20.00) for any two-week period;

(3) Each loan shall be made against the assignment of the participant's entire right, title, and interest in and to the trust, supported by the participant's collateral promissory note for the amount of the loan, including interest payable to the order of the trustee;

(4) Each loan shall bear interest at a rate determined by the Board ~~which shall be in line with the prime lending rate plus one or two percentage points above the prime rate.~~ The Board shall not discriminate among participants in its determination of interest rates on loans. Loans initiated at different times may bear different interest rates, ~~where, in the opinion of the Board, the difference in rates is supported by a change in market interest rates or a~~

~~change in the pension system's current assumed rate of return. The loan interest rate shall bear a reasonable relationship to market rates for secured loans of a similar duration and shall bear a reasonable relationship to the costs to the pension trust of administering the trust. The loan interest rate shall be calculated in a manner that will not negatively affect the City's costs to the trust or the return to trust members;~~

~~(5) Cost of administering the annuity loan program shall be borne by the participant obtaining a loan by and through a loan origination and administration fee that shall be assessed and included in the loan amount.~~

~~(5)(6)~~ Loan repayments shall be suspended under this plan as permitted by Section 414(u)(4) of the Internal Revenue Code, 26 U.S.C. 414(u)(4). A participant who has an outstanding loan balance from the plan who is absent from employment with the employer, and who has satisfied the requirements of 26 USC 414(u) of the Internal Revenue Code shall not be required to make loan repayments to the fund during said periods of absence.

_____ (f) *Renewal of Loan.* Any loans granted or renewed shall be made pursuant to the participant loan program and Section 72(p) of the Internal Revenue Code, 26 U.S.C. 72(p) and the regulations thereunder.

_____ (g) *Loan Balance.* A participant's outstanding loan balance shall be considered a directed investment by the participant and interest payments, shall be credited to the participant's account balance, and shall not be part of net investment income or part of the participant's account balance for the purpose of allocation of net investment income under Section 47-2-18 of this Code.

_____ (h) *Distributions.* No distributions shall be made to a participant, former participant, or beneficiary until all loan balances drawn on the applicable vested accumulated balance and applicable accrued interest have been liquidated.

(i) Annual Report. The General Retirement System shall include, in their annual report to all members, an accounting of the loan program established by this section, which contains the number and amount of loans made, the costs of administering the program, ~~the amount of origination fees collected, the amount of administration fees collected, the number of loans made and the total dollar amount of loans in the fiscal period of the report,~~ the amount of payments made including interest received by the trust, the amount of loans outstanding, ~~specifically including any defaults or delinquencies, and an evaluation as to whether the interest charged in that fiscal year covered the costs of administering the program.~~

~~Secs. 47-2-22~~ 47-2-23 - 47-2-30. Reserved.

Section 2. All ordinances, or parts of ordinances, that conflict with this ordinance are repealed.

Section 3. This ordinance is declared necessary for the preservation of the public peace, health, safety, and welfare of the People of the City of Detroit.

Section 4. In the event that this ordinance is passed by a two-thirds (2/3) majority of the City Councils Members serving, it shall be given immediate effect and become effective upon publication in accordance with Section 4-116 of the 1997 Detroit City Charter. In the event that this ordinance is passed by a less than two-thirds (2/3) majority of the City Council Members serving, it shall become effective no later than thirty (30) days after enactment in accordance with Section 4-115 of the 1997 Detroit City Charter.

Approved as to form:

John E. Johnson, Jr.
Corporation Counsel

City of Detroit

CITY COUNCIL

IRVIN N CORLEY, JR.
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ANNE MARIE LANGAN
DEPUTY DIRECTOR
(313) 224-1078

TO: Councilmembers

FROM: Irvin Corley, Jr., Director *ICJ.*
Anne Marie Langan, Deputy Director *AML*

DATE: February 8, 2008

RE: Proposed Ordinance for the Employee Loan Program (**Revised**)

On January 31, 2008, in the City Council's Internal Operations Committee a city Law Department-formatted version of the proposed ordinance amendment of Chapter 47 of the 1984 City Code, "Retirement Systems", to add section 47-2-22, "Participant Loan Program", whereby a participant of the 1973 Defined Contribution Plan may borrow funds from his or her own account subject to the approved requirements and limitations.

Following are the questions our office has regarding the actual ordinance document. These questions will need to be answered by either the Pension Trustees or the Law Department.

1. On page 2, line 7, subsection (b) (1), we believe that "the City of Detroit Retirement System" should be written as "the City of Detroit General Retirement System" in order to follow the use of General in line 11 on page 2.

2. On page 2, line 19, subsection (c):

"(c) Eligibility loans shall be made only to participants, former participants, spouses of participants, and beneficiaries re not eligible to receive any loans from the Plan."

We believe this needs to read:

"(c) *Eligibility*. Loans shall be made only to participants. Former participants, spouses of participants and beneficiaries are not eligible to receive any loans from the Plan."

3. On page 3, line 2 subsection (d), there are 2 apostrophes instead of 1 in "participant's".
4. On page 3, line 11, subsection (e) Terms and Conditions, subsection (2) is it thought that this repayment deduction will be able to be implemented prior to the rollout of the new payroll system? Would this program be given greater priority than implementation of the 1998 Defined Contribution Plan? Is the current payroll system capable of handling the deductions required for the loan program?
5. On page 3, line 18, subsection (e) (4), there is language that establishes the pension board as determining interest rates. Why is this fundamental piece left to the board through the years and not more clearly defined in the body of the ordinance? It could be written, "to equal the current assumed rate of the pension systems rate of return" or perhaps the wording should include language that supports that no costs to running this program will be born by the pension system affecting the systems earnings and thereby increasing the City's costs to the system, and therefore will be included in the interest rate. The current language places the rate near market but not at market. If the individual could borrow in the market, they wouldn't be doing it through the pension system, thus they automatically can be considered higher risk and the interest rate should reflect this. In 401k loan programs, the interest rate paid mirrors what the fund actual made each month so the interest rate varies monthly.
6. On page 4, line 1, subsection (e) (5), allows suspension of loan repayment under certain conditions. Why doesn't this language explain how the interest owed will be handled? Will it continue to accrue and should the interest payment continue to be made to cover all administrative costs of the program?
7. On page 4, line 6, subsection (f) "Renewal of Loan" – may the participant take another loan if the first loan is paid off? Or may they have multiple loans, which are staggered if they do not exceed \$10,000 in total? Was there any intent to have a limit on the number of times that a participant could participate?

Part of the concern of a loan program, is that it can slow down the growth of retirement savings, that U.S. citizens as a whole have had difficulty generating at a sufficient level. The main concern is with those who choose to borrow and opt out of new contributions during the repayment period. Attached is Table I, which shows actual interest rates, earned by annuity participants in the last 15 years. A repayment of a \$10,000 loan if one continues to contribute new money would have reduced the balance by \$1,800, a 1.4% loss. However if the participant must stop new contributions in order to repay the loan, the balance after 15 years would be lowered by \$27, 600, a 21.6% drop. If participants are able to renew these loans, the losses could be greater.

According to a 2007 report by Fidelity Investments of the 13,000 401k plans they administer for 10 million participants with \$647 billion in assets, the percentage of participants who had outstanding 401k loans was 20% between the years 2003 and 2006. The average number of loans per participant was 1.4 and the average outstanding loan amount was \$6,100. The weighted average total outstanding loan amount as percentage of account balance was 14%. The entire report (165 pages) can be found on the web at www.buildingfutures.fidelity.com .

Throughout the retirement savings literature there is consistency in the statement that retirement savings should be a last resort for individuals to turn in order to address current financial difficulties.

We urge that, if this ordinance amendment is approved, the amendment must have clear language that the program must be structured to pay for itself and paid for only by the members who choose to use the program. We also strongly urge that the ordinance should be amended to include language that says that annually the pension system will provide a written report to Council and the Administration that reflects the cost of the program for the previous year and how the costs were covered.

Attachments (11)

cc: Council Divisions
Auditor General
Norman White, Finance Director
Audrey Jackson, Deputy Finance Director
Pamela Scales, Budget Director
Barbara Wise-Johnson, Labor Relations Director
John Johnson, Corporation Counsel
Walter Stampor, Executive Secretary, Retirement Systems
Dennis Mazurek, Law Department
Kerwin Wimberley, Mayor's Office

Table I
Comparing Outcomes on Annuity Balances with Employee Loan Program in Place

Annuity Growth - Without Loan									
Date	Year	Savings	Reg. Int. Rate	Amount - Reg Interest	Bonus Int. Rate	Bonus Interest	Amount - Loan	Amount - Loan Repayment	Cumulative Growth
06/30/2007	15	\$ 2,450.00	7.90%	\$ 8,143.37	15.09%	\$ 15,554.88			\$ 126,778.93
06/30/2006	14	\$ 2,450.00	7.90%	\$ 6,550.07	13.47%	\$ 11,168.29			\$ 100,630.68
06/30/2005	13	\$ 2,450.00	7.90%	\$ 5,818.86	1.34%	\$ 987.00			\$ 80,462.32
06/30/2004	12	\$ 2,450.00	7.90%	\$ 5,213.45	0.00%	\$ -			\$ 71,206.46
06/30/2003	11	\$ 2,450.00	7.90%	\$ 4,652.36	0.00%	\$ -			\$ 63,543.02
06/30/2002	10	\$ 2,450.00	7.90%	\$ 4,132.36	0.00%	\$ -			\$ 56,440.65
06/30/2001	9	\$ 2,450.00	7.90%	\$ 3,650.42	0.00%	\$ -			\$ 49,858.30
06/30/2000	8	\$ 2,450.00	7.90%	\$ 3,013.05	6.83%	\$ 2,604.95			\$ 43,757.88
06/30/1999	7	\$ 2,450.00	7.90%	\$ 2,353.70	11.89%	\$ 3,542.47			\$ 35,689.87
06/30/1998	6	\$ 2,450.00	7.50%	\$ 1,642.59	17.35%	\$ 3,799.87			\$ 27,343.70
06/30/1997	5	\$ 2,450.00	7.50%	\$ 1,177.15	16.43%	\$ 2,578.75			\$ 19,451.24
06/30/1996	4	\$ 2,450.00	7.50%	\$ 839.38	10.85%	\$ 1,214.30			\$ 13,245.35
06/30/1995	3	\$ 2,450.00	7.50%	\$ 609.88	0.00%	\$ -			\$ 8,741.67
06/30/1994	2	\$ 2,450.00	7.50%	\$ 388.63	2.15%	\$ 111.41			\$ 5,681.79
06/30/1993	1	\$ 2,450.00	7.50%	\$ 183.75	4.00%	\$ 98.00	\$ -	\$ -	\$ 2,731.75
		\$ 36,750.00		\$ 48,369.03		\$ 41,659.90	\$ -	\$ -	\$ 126,778.93

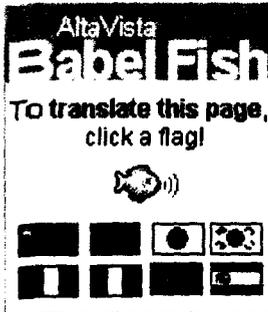
Annuity Growth - With Loan and Continued Savings									
Date	Year	Savings	Reg. Int. Rate	Amount - Reg Interest	Bonus Int. Rate	Bonus Interest	Amount - Loan	Amount - Loan Repayment	Cumulative Growth
06/30/2007	15	\$ 2,450.00	7.90%	\$ 8,023.74	15.09%	\$ 15,326.36			\$ 124,916.47
06/30/2006	14	\$ 2,450.00	7.90%	\$ 6,451.51	13.47%	\$ 11,000.23			\$ 99,116.36
06/30/2005	13	\$ 2,450.00	7.90%	\$ 5,728.63	1.34%	\$ 971.69			\$ 79,214.63
06/30/2004	12	\$ 2,450.00	7.90%	\$ 4,974.61	0.00%	\$ -		\$ 2,120.00	\$ 70,064.31
06/30/2003	11	\$ 2,450.00	7.90%	\$ 4,275.79	0.00%	\$ -		\$ 2,120.00	\$ 60,519.70
06/30/2002	10	\$ 2,450.00	7.90%	\$ 3,628.14	0.00%	\$ -		\$ 2,120.00	\$ 51,673.91
06/30/2001	9	\$ 2,450.00	7.90%	\$ 3,027.90	0.00%	\$ -		\$ 2,120.00	\$ 43,475.78
06/30/2000	8	\$ 2,450.00	7.90%	\$ 3,013.05	6.83%	\$ 2,604.95	\$(10,000.00)	\$ 2,120.00	\$ 35,877.88
06/30/1999	7	\$ 2,450.00	7.90%	\$ 2,353.70	11.89%	\$ 3,542.47			\$ 35,689.87
06/30/1998	6	\$ 2,450.00	7.50%	\$ 1,642.59	17.35%	\$ 3,799.87			\$ 27,343.70
06/30/1997	5	\$ 2,450.00	7.50%	\$ 1,177.15	16.43%	\$ 2,578.75			\$ 19,451.24
06/30/1996	4	\$ 2,450.00	7.50%	\$ 839.38	10.85%	\$ 1,214.30			\$ 13,245.35
06/30/1995	3	\$ 2,450.00	7.50%	\$ 609.88	0.00%	\$ -			\$ 8,741.67
06/30/1994	2	\$ 2,450.00	7.50%	\$ 388.63	2.15%	\$ 111.41			\$ 5,681.79
06/30/1993	1	\$ 2,450.00	7.50%	\$ 183.75	4.00%	\$ 98.00	\$ -	\$ -	\$ 2,731.75
		\$ 36,750.00		\$ 46,318.45		\$ 41,248.02	\$(10,000.00)	\$ 10,600.00	\$ 124,916.47

Annuity Growth - With Loan and Savings Discontinued During Loan Repayment Term									
Date	Year	Savings	Reg. Int. Rate	Amount - Reg Interest	Bonus Int. Rate	Bonus Interest	Amount - Loan	Amount - Loan Repayment	Cumulative Growth
06/30/2007	15	\$ 2,450.00	7.90%	\$ 6,379.02	15.09%	\$ 12,181.29			\$ 99,307.41
06/30/2006	14	\$ 2,450.00	7.90%	\$ 5,096.21	13.47%	\$ 8,691.94			\$ 78,297.10
06/30/2005	13	\$ 2,450.00	7.90%	\$ 4,487.97	1.34%	\$ 761.25			\$ 62,058.96
06/30/2004	12	\$ -	7.90%	\$ 3,824.78	0.00%	\$ -		\$ 2,120.00	\$ 54,359.74
06/30/2003	11	\$ -	7.90%	\$ 3,389.53	0.00%	\$ -		\$ 2,120.00	\$ 48,414.96
06/30/2002	10	\$ -	7.90%	\$ 2,986.14	0.00%	\$ -		\$ 2,120.00	\$ 42,905.43
06/30/2001	9	\$ -	7.90%	\$ 2,612.29	0.00%	\$ -		\$ 2,120.00	\$ 37,799.28
06/30/2000	8	\$ -	7.90%	\$ 2,819.50	6.83%	\$ 2,437.62	\$(10,000.00)	\$ 2,120.00	\$ 33,066.99
06/30/1999	7	\$ 2,450.00	7.90%	\$ 2,353.70	11.89%	\$ 3,542.47			\$ 35,689.87
06/30/1998	6	\$ 2,450.00	7.50%	\$ 1,642.59	17.35%	\$ 3,799.87			\$ 27,343.70
06/30/1997	5	\$ 2,450.00	7.50%	\$ 1,177.15	16.43%	\$ 2,578.75			\$ 19,451.24
06/30/1996	4	\$ 2,450.00	7.50%	\$ 839.38	10.85%	\$ 1,214.30			\$ 13,245.35
06/30/1995	3	\$ 2,450.00	7.50%	\$ 609.88	0.00%	\$ -			\$ 8,741.67
06/30/1994	2	\$ 2,450.00	7.50%	\$ 388.63	2.15%	\$ 111.41			\$ 5,681.79
06/30/1993	1	\$ 2,450.00	7.50%	\$ 183.75	4.00%	\$ 98.00	\$ -	\$ -	\$ 2,731.75
		\$ 24,500.00		\$ 38,790.53		\$ 35,416.88	\$(10,000.00)	\$ 10,600.00	\$ 99,307.41

Savings Assumes average salary of 35,000 transferring 7% into Annuity Savings Program
Loan Repayment Assumes loan of \$10,000 at 6% simple interest to be repaid over 5 years.

GuideTo401kLoans.com

Information on 401(k) Loans - February 4, 2008



Making loans available within a 401(k) plan is allowed by law, but an employer is not required to do so. Many small business just can't afford the high cost of adding this feature to their plan. Even so, loans are a feature of most 401(k) plans. If offered, an employer must adhere to some very strict and detailed guidelines on making and administering them.

Here is the basic information you should know about all 401(k) loans.

401(k) Loan Basics

1. Assuming that you have had no other 401(k) plan loan in the last 12 months, you are allowed to borrow up to 50% of your vested account balance to a maximum of \$50,000.
2. Loan payments are generally deducted from your payroll checks.
3. The interest rate will vary by plan, but the rate most often used is what is termed the "prime rate" plus one or two percent. The current "prime rate" can be found in the business section of your local newspaper or the Wall Street Journal.
4. Funds obtained from a loan are not subject to income tax or the 10% early withdrawal penalty (unless the loan defaults).
5. If you should terminate your employment with the plan sponsor, often any unpaid loan will be distributed to you as income. The amount will then be subject to income tax and may also be subject to 10% withdrawal penalty.
6. A 401(k) loan can't be rolled over to an IRA.
7. You can always repay your loan at any time with no penalties.
8. In some plans you will be required to obtain the consent of your spouse before you can obtain the loan.

Just because you can obtain a loan from your plan doesn't mean it is always the best idea. So before sticking your hand in the cookie jar, you should consider the "pros and cons," some of which may surprise you. And remember, the purpose of a 401(k) plan is to fund your retirement, so don't shortchange your golden years by treating it as a checking account.

The Pros:

1. It's convenient. There is no credit check or long credit application form. Some plans only require you to make a phone call, while others require a short loan form.
2. There is a low interest rate. You pay the rate set by the plan, usually one or two percentage points above the prime rate.
3. There usually are no restrictions. Most plans allow you to borrow for any reason.
4. You are paying the interest to yourself, not to the bank or credit card company.

5. The interest is tax-sheltered. You don't have to pay taxes on the interest until retirement, when you take money out of the plan.
6. You choose where the money comes from. The advantage of being able to choose which investment option you will sell in order to obtain the funds for your loan is that you can leave untouched those investments with the best performance.

The Cons:

1. There are "opportunity" costs. According to the U.S. General Accounting Office, the interest rate paid on a plan loan is often less than the rate the plan funds would have otherwise earned.
2. Smaller contributions. Because you now have a loan payment, you may be tempted to reduce the amount you are contributing to the plan and thus reduce your long-term retirement account balance.
3. Loan defaults can be harmful to your financial health. If you quit working or change employers, the loan must be paid back right away. It's not uncommon for plans to require full repayment of a loan within 60 days of termination of employment. If you can't repay the loan, it is considered defaulted, and you will be taxed on the outstanding balance, including an early withdrawal penalty if you are not at least age 59 ½.
4. There may be fees involved.
5. Interest on the loan is not tax deductible, even if you borrow to purchase your primary home.
6. You have no flexibility in changing the payment terms of your loan.

When You Probably Shouldn't Borrow From Your Plan

It is probably not wise to take out a 401(k) plan loan when:

1. You are planning to leave your job within the next couple of years.
2. There is a chance you will lose your job due to a company restructuring.
3. You are nearing retirement.
4. You can obtain the funds from other sources.
5. You can't continue to make regular contributions to your plan.
6. You can't pay off the loan right away if you are laid off or change jobs.
7. You need the loan to meet everyday living expenses.
8. You want the money to purchase some luxury item or pay for a vacation.

Commonly Asked Questions:**What are some of the most common reasons people take out a plan loan?**

The most common reasons of a plan loan are:

1. To pay college tuition.
2. Uninsured medical expenses.
3. The purchase of a primary residence.

4. Payments necessary to prevent being evicted or defaulting on a mortgage.

If I want to borrow for a down payment on the purchase of my primary residence, do I have to pay the loan back in five years like a normal 401(k) loan?

No, most plans allow longer pay back terms when the loan is going to be used to purchase a primary residence. Ten to fifteen years is common.

How long do I have to pay off my loan if I quit my job?

Typically, if you quit working or change employers, it is not uncommon for plans to require full repayment of a loan within 60 days of termination of employment.

Will a 401(k) loan appear on my credit report?

Loans from your 401(k) are not reported to the credit-reporting agencies, but if you are applying for a mortgage, lenders will ask you if you have such loans and they will count the loan as debt.

If I default on my loan, will the default be reported to the credit-reporting agencies?

If you default on a 401(k) loan, the default will not be reported to the credit-reporting agencies and it will not negatively impact your credit rating.

If I can't afford to keep making the payments on my loan, can I stop them?

Once the loan has been made, your payments will be deducted from your pay each month and you generally can't stop this process..

If I default on my loan, how will I know the amount I must report as income on my federal tax return?

You will receive a 1099 from the plan which will show you the exact amount to report. This amount will also be reported to the IRS.

I still have a 401(k) account at a former employer. Can I get a loan from this old 401(k)?

Plans are not required to let former employees take plan loans and few allow them to do so.

Where can I learn more about how my specific plan handles 401(k) loans?

Talk to your plan administrator or ask them for a copy of your plan's Summary Plan Description (also known as an SPD). The SPD will spell out exactly how and why you can obtain a loan from your 401(k).

For more background and information on 401k plan loans, check out these resources:

Don't Tap Your 401k to Pay Off Debt - Summary: If you take money out of your 401(k) to pay off your debts, you may regret it later. Taking out a loan or an early withdrawal will reduce your eventual retirement account and may force you to work longer.

401k Loans: When You Need Your money NOW - Summary: Ideally, you will never touch your retirement funds, allowing them to grow continuously until you retire. But we don't live in an ideal world! In case of emergency, the funds in your 401k may be available to you in the form of a Loan....let's assume you have an unexpected crisis and you need your money -- what should you know?

Retirement Loans - Summary: Retirement plan loans are generally easy to obtain. And there are not a lot of expenses attributed to them. And if your credit is less than golden, you might find it easier and cheaper to borrow from your retirement plan than from a commercial lender. But, there are pros and cons.

Need Cash? Don't Rob Your 401k - Summary: People hard up for cash — whether they've been set back by a job loss or a disaster such a Hurricane - may be tempted to tap their 401k accounts and other company-sponsored retirement plans. But this should be a last resort, not only because they face possible penalties but also because it undercuts their long-term security.

Raiding 401k to Repay Credit Card Debt - Summary: "I'm considering borrowing from my retirement savings to pay off some of this debt. Do you think this is wise?"

U.S. Labor Department Action Helps Hurricane Victims Access 401k Plans - Summary: The U.S. Department of Labor's Employee Benefits Security Administration (EBSA), along with the Internal Revenue Service (IRS), announced guidance for employers and plan officials to help victims of Hurricane Katrina obtain distributions and loans through 401k and similar employer-sponsored plans.

Got a question or looking for more information? [Read our forum on the subject by clicking here.](#)

Remember, the information on this web page is provided as general guidance on the subject of 401(k) plan loans and is not provided as legal, tax or investment advice. Individual situations vary, so consult your tax, legal or financial advisor for more detailed information and advice.

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SUMMARY

This proposed ordinance amends Chapter 47 of the 1984 Detroit City Code , *Retirement Systems*, Article II, *1973 Defined Benefit/defined Contribution (Annuity) Plan of the General Retirement System*, by adding Section 47-2-22, *Participant Loan Program*, to provide a loan program whereby a participant of the 1973 Defined Contribution Plan may borrow funds from his or her own account subject to requirements and limitations of: 1) this Chapter, 2) the United States Internal Revenue Code, and (3) the Board of Trustees of the General Retirement System, which may be established from time to time.

Received
at 1/31/08
subll

1 **BY COUNCIL MEMBER _____:**

2 **AN ORDINANCE** to amend Chapter 47 of the 1984 Detroit City Code *Retirement Systems*,
3 Article II, 1973 *Defined Benefit/defined Contribution (Annuity) Plan of the General Retirement*
4 *System*, by adding Section 47-2-22, *Participant Loan Program*, to provide a loan program whereby
5 a participant of the 1973 Defined Contribution Plan may borrow funds from his or her own account
6 subject to requirements and limitations of: 1) this Chapter, 2) the United States Internal Revenue
7 Code, and (3) the Board of Trustees of the General Retirement System, which may be established
8 from time to time.

9 **IT IS HEREBY ORDAINED BY THE PEOPLE OF THE CITY OF DETROIT THAT:**

10 **Section 1.** Chapter 47 of the 1984 Detroit City Code *Retirement Systems*, Article II, 1973
11 *Defined Benefit / Defined Contribution (Annuity) Plan of the General Retirement System*, by adding
12 Section 47-2-22, *Participant Loan Program*, to read as follows:

13 **CHAPTER 47. RETIREMENT SYSTEMS**

14 **ARTICLE II.**

15 **1973 DEFINED BENEFIT / DEFINED CONTRIBUTION**
16 **(ANNUITY) PLAN OF THE GENERAL RETIREMENT SYSTEM.**

17
18 **Sec. 47-2-22. Participant Loan Program.**

19 (a) Established. Any loans granted or renewed shall be made pursuant to a Participant Loan
20 Program which shall conform with the requirements of Section 72(p) of the Internal Revenue Code.
21 Such loan program shall be established in writing by the Board of Trustees, and must include, but
22 need not be limited to the following:

23 (1) The identity of the administrator of the Participant Loan Program;

- 1 (2) A procedure to apply for loans; the amount of loan that will be approved or denied,
2 limitations, if any, on the types and amount of loans offered;
- 3 (3) The procedures under the program for determining a reasonable rate of interest; and
- 4 (4) The events constituting default and the steps that will be taken to preserve plan assets.

5 (b) *The Loan Program.*

6 (1) This Loan Program shall be contained in a separate written document copies of which
7 shall be made available in the offices of the City of Detroit Retirement System for
8 prospective participants in the program. The Board of Trustees is authorized, from
9 time to time, to adopt rules and regulations to govern the administration and the
10 operation of this program. Copies of the rules shall also be made available to
11 prospective participating members of the system in the offices of the General
12 Retirement System.

13 (2) All collective bargaining agreements which accept the terms of this ordinance are
14 specifically agreeing to the subject to the board's power to modify or amend the
15 Participant Loan Program from time to time, including during the effective term of
16 the applicable labor agreement and no such modification or amendment shall be
17 deemed a violation of said labor agreement and no grievance or other form of action
18 shall be effective to overturn or alter the board's decision.

19 (c) Eligibility loans shall be made only to participants, former participants, spouses of
20 participants, and beneficiaries are not eligible to receive any loans from the Plan. Subject to rules
21 and procedures established by the board, a participant who has been in the plan for twelve months
22 or more is eligible to apply for a loan from this plan.

1 (d) Amount of Loan. A participant who has satisfied applicable rules and procedures may
2 borrow from the participant's accounts an amount which does not exceed fifty percent (50%) of the
3 participant's vested accumulated balance, or ten thousand dollars (\$10,000.00) reduced by the
4 excess, if any, of 1) the highest outstanding balance of loans from the trust during the one year period
5 ending on the day before the date on which the loan is made, or 2) the outstanding balance of loans
6 from the trust on the date on which the loan is made whichever is less. The minimum loan amount
7 shall be one thousand dollars (\$1,000.00).

8 (e) Terms and Conditions. In addition to such rules and procedures as established by the
9 board, all loans shall comply with the following terms and conditions:

- 10 (1) Loan applications shall be in writing;
- 11 (2) Loans shall be repaid by equal payroll deductions over a period not to exceed five
12 years, or, if the loan is for the purpose of buying a principal residence, a period not
13 to exceed fifteen years. In no case shall the amount of the payroll deduction be less
14 than twenty dollars (\$20.00) for any two-week period;
- 15 (3) Each loan shall be made against the assignment of the participant's entire right, title
16 and interest in and to the trust, supported by the participant's collateral promissory
17 note for the amount of the loan, including interest payable to the order of the trustee;
- 18 (4) Each loan shall bear interest at a rate determined by the board. The board shall not
19 discriminate among participants in its determination of interest rates on loans. Loans
20 initiated at different times may bear different interest rates, where, in the opinion of
21 the Board, the difference in rates is supported by a change in market interest rates.
22 The loan interest rate shall bear a reasonable relationship to market rates for secured
23 loans of a similar duration;

1 (5) Loan repayments shall be suspended under this plan as permitted by Section
2 414(u)(4) of the Internal Revenue Code. A participant who has an outstanding loan
3 balance from the plan who is absent from employment with the employer, and who
4 has satisfied the requirements of 26 USC 414(u) of the Internal Revenue Code shall
5 not be required to make loan repayments to the fund during said periods of absence.

6 (f) Renewal of Loan. Any loans granted or renewed shall be made pursuant to the
7 participant loan program and Section 72(p) of the Internal Revenue Code and the regulations
8 thereunder.

9 (g) Loan Balance. A participant's outstanding loan balance shall be considered a directed
10 investment by the participant and interest payments shall be credited to the participant's account
11 balance and shall not be part of net investment income nor part of the participant's account balance
12 for the purpose of allocation of net investment income under Section 47-2-18 of this Code.

13 (h) Distributions. No distributions shall be made to a participant, former participant, or
14 beneficiary until all loan balances drawn on the applicable vested accumulated balance and
15 applicable accrued interest have been liquidated.

16 Secs. ~~47-2-22~~ 47-2-23 – 47-2-30. Reserved.

17 Section 2. All ordinances, or parts of ordinances, that conflict with this ordinance are
18 repealed.

19 Section 3. This ordinance is declared necessary for the preservation of the public peace,
20 health, safety, and welfare of the People of the City of Detroit.

1 **Section 4.** In the event that this ordinance is passed by a two-thirds (2/3) majority of the
2 City Council Members serving, it shall be given immediate effect and become effective upon
3 publication in accordance with Section 4-116 of the 1997 Detroit City Charter. In the event that this
4 ordinance is passed by a less than two-thirds (2/3) majority of the city Council Members serving, it
5 shall become effective no later than thirty (30) days after enactment in accordance with Section 4-
6 115 of the 1997 Detroit City Charter.

7
8 Approved as to form:

9
10
11 _____
12 John E. Johnson, Jr.
13 Corporation Counsel